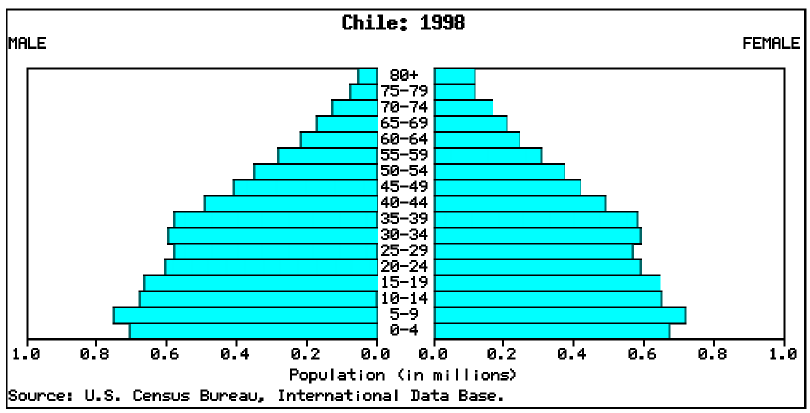
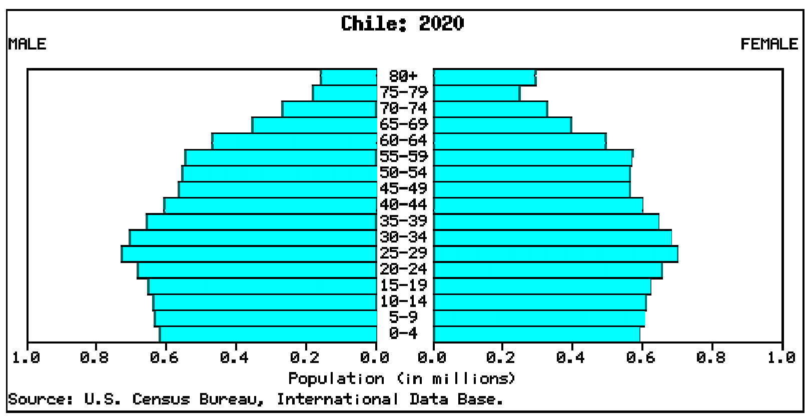
# Chile

| Summary of Current System | | | |
|---|---|---|---|
| | **Pillar 1** | **Pillar 2** | **Pillar 3** |
| **Type:** | ♦ Defined-benefit | ♦ Defined-contribution | ♦ Defined-contribution |
| **Participation:** | ♦ Mandatory for those workers who opted to remain in the system prior to May 1986 | ♦ Mandatory for workers who entered the labor force after 1986 | ♦ Voluntary |
| **Management:** | ♦ Publicly-managed | ♦ Privately-managed | ♦ Privately-managed |
| **Financing:** | ♦ PAYGO | ♦ Fully-funded | ♦ Fully-funded |
| **Coverage:** | ♦ All workers | ♦ All workers | ♦ Participating workers |
| **Eligibility:** | ♦ Age 65 for men and 60 for women | ♦ Age 65 for men and 60 for women | ♦ Age 65 for men and 60 for women |

## Challenges Facing Pension System

- ❑ Low compliance rate
- ❑ High administrative costs




## Summary of Current System

In May 1981, the Government of Chile replaced a bankrupt defined-benefit, pay-as-you-go (PAYGO) pension system (Pillar I) with a privately-managed, defined-contribution system (Pillar II). The current system consists of mandatory Pension Savings Accounts (PSAs) administered by competing private pension fund administrators or *Administradoras de Fondos de Pensiones* (AFPs).

All participants of the previous system were given the option of participating in the new system or remaining in the old system. Those remaining in the old system if still employed after May 1986 were obligated to join the new pension system. After this time, participation in the new system also became mandatory for new labor force entrants and voluntary for the self-employed. The new system is publicly supervised and regulated, but otherwise managed by private pension fund administrators.

Contributions to the current pension system are paid by the employee, with 10 percent of wages allocated to pension benefits and 3 percent of wages allocated to survivor and disability benefits. Employees may voluntary contribute up to 10 percent of salary for further savings.

The old system, which consists of the Social Security Service (SSS) for blue-collar workers and the Private Employee Fund for white-collar workers, is gradually being phased out. Government expenditures for these programs are projected to continue until 2050, when there should no longer be any beneficiaries in the old system.

Affiliates to the pension system begin receiving benefits when they reach the retirement age, which is 65 years for men and 60 years for women. Pension benefits are based on total contributions plus accrued earnings. Early retirement is permitted for those workers who have accrued enough funds to provide a pension equal to at least 50 percent of their indexed wage over the last 10 years and is at least equal to 110 percent of the minimum old age pension. Upon retirement, workers may use accumulated funds to purchase a lifetime annuity or

# Chile

| SELECTED INDICATORS | | |
|---|---|---|
| *Demographic* | *Year* | |
| | *1998* | *2020* |
| Total Population (in thousands) | 14,787 | 18,159 |
| Life Expectancy at Birth (Years) | 75.16 | 79.52 |
| Total Fertility Rate (Child Born per Woman) | 2.3 | 1.8 |
| Age Dependency Ratio (percent) | 16.3 | 28.1 |
| | *1980-2000* | *2000-2020* |
| Average Annual Rate of Population Growth (percent) | 1.6 | 0.9 |

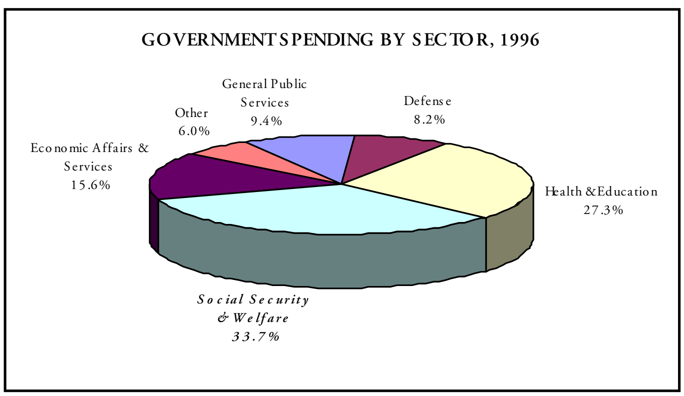
*Source: U.S. Bureau of the Census. International Data Base.*

| *Economic* | *1996* |
|---|---|
| GNP (PPP in billions)[1] | 168.7 |
| GNP Average Annual Growth Rate, 1995-1996 (percent)[1] | 10.1 |
| GNP Per Capita (in PPP)[1] | 11,700 |
| Inflation Rate (percent)[2] | 7.4 |
| Labor Force Participation Rate (percent)[3] | 40.1 |
| Unemployment Rate (percent)[3] | 5.4 |

*Source: [1]World Bank; [2]IMF; [3]International Labour Office.*

| *Pension* | *1997* |
|---|---|
| System Dependency Ratio (percent)[1] | 24.3 |
| Employee Contribution for Pensions (percent of earnings)[2] | 11.0 |
| Employer Contribution for Pensions (percent of payroll)[2] | None |
| Public Pension Spending as % of Government Spending | n/a |
| Public Pension Spending as % of GDP, 1993 (percent)[1] | 5.8 |

*Source: [1]World Bank; [2]U.S. Social Security Administration.*




*Source: International Monetary Fund. Government Finance Statistics Book, 1997.*

may keep the account with the pension fund administrator and make periodic withdrawals.

For those who have reached retirement age and have contributed for at least 20 years, the government guarantees a minimum pension equal to 85 percent of the minimum wage. The government also pays for a subsistence pension to those who are not eligible for the minimum pension.

## Pension Reform Efforts

Chile became the first country in the world to transition from a publicly-managed pension system to individual capitalized accounts. The Chilean system has become a popular model for other countries undergoing pension reform throughout the world. As of 1997, there were approximately 5.1 million affiliates enrolled in the new system and 15 AFPs authorized to administer private pension accounts in Chile.

To facilitate the transition to the new system, the Chilean government accumulated a budgetary surplus, amounting to 5.5 percent of the GDP. Employer contributions were eliminated. Employees were given a one-time salary increase of 17 percent in March 1981 to compensate for the change requiring employees to pay all contributions and to encourage transferring into the new system. Those who switched from the old to the new system were given recognition bonds, which credited their previous contributions from the old to the new pension system.

While pension funds are managed privately, the government continues to have a large financial and administrative role. The government redistributes payments to low-income workers by guaranteeing a minimum benefit; all workers are required to pay a percentage of salary for retirement and insure against disability and for survivors; and workers may voluntarily contribute an additional amount for retirement.

## Challenges Facing Pension System

The new system suffers from a low rate of coverage compliance. As of March 1998, only 60 percent of all affiliates to the system were contributing on a regular basis, partly as a result of unemployment and seasonal unemployment as well as a result of those who make contributions only to qualify for the government guaranteed minimum pension. It is estimated that approximately 30 to 40 percent of workers currently in the system may become eligible for the minimum pension, most likely as a result of low or underreported earnings.

Another challenge to the current system is the high administrative costs to the AFPs as a result of account switching. Affiliates are allowed to switch from one AFP to another every four months. To discourage frequent account switching, legislation was proposed in 1996 that would require affiliates to remain with an AFP for at least one to three years. As of yet, the legislation has not been passed.

### Pension Reform Efforts by Pillar

| | Pillar 1 | Pillar 2 | Pillar 3 |
|---|---|---|---|
| **Papers issued on state of pension systems** | | ✓ | ✓ |
| **Formulation of proposals** | | ✓ | ✓ |
| **Development of draft legislation** | | ✓ | ✓ |
| **Introduction of legislation by parliament** | | ✓ | ✓ |
| **Review of legislation by parliament** | | ✓ | ✓ |
| **Passage of legislation by parliament** | | ✓ | ✓ |
| **Implementation of legislation** | | ✓ | ✓ |